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C O N F I D E N T I A L SECTION 01 OF 04 HARARE 000061

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E.O. 12958: DECL: 01/27/2019
TAGS: ECON EFIN PGOV ZI
SUBJECT: GOZ TO ANNOUNCE DOLLARIZATION OF THE ECONOMY

REF: HARARE 0049

Classified By: Ambassador James D. McGee for reason 1.4 (b) & (d).

SUMMARY

¶1. (C) According to Senior Advisor to Reserve Bank of Zimbabwe (RBZ) Governor Gono Munyaradzi Kereke, the GOZ plans to announce the "informal" dollarization of the economy and further market and exchange-rate reforms this week. All businesses will be allowed to transact in hard currencies, but the Zimbabwe dollar will also remain in circulation. The GOZ intends to begin paying civil servants in hard currency. Tax revenues in hard currency and possibly diamond revenues are expected to finance government expenditures. Embassy business contacts regard the GOZ's tax revenue projections as "delusional," and diamond revenue projections as equally unreasonable. Pressure on the GOZ to source foreign exchange is intense as formal economic activity has drawn to a near standstill, dollarization of the economy is pervasive, and demand for local currency, including from civil servants, has evaporated. The GOZ's muddled understanding of dollarization and its failure to engage the international financial institutions
makes it unlikely that the policy shift will arrest the formal economy's precipitous contraction. END SUMMARY.

GOZ to Accept Dollarization

¶2. (C) Kereke told econoff on January 23 that the GOZ planned to announce the "informal" dollarization of the economy and a handful of market reforms in a budget statement on January

29, to be followed soon after by a monetary policy statement. He said the RBZ would continue to print Zimbabwe dollars, which would remain in "co-circulation" with hard currencies. Recognizing that the economy had fully dollarized since the introduction of registered dollar stores in late 2008 and the proliferation of unregistered hard-currency based vendors, the government had decided to allow all businesses to sell goods and services in hard currencies as long as they registered with the RBZ; there would be no license or registration fee. Kereke said prices would be freed and the mandate of the widely reviled National Income and Pricing Commission (NIPC) starkly reduced. Kereke maintained that the amount of foreign exchange in circulation in Zimbabwe was "much higher" than private sector estimates and that it would be the e
ngine of growth. (COMMENT: He declined to provide a figure. END COMMENT.)

¶3. (C) The RBZ, according to Kereke was still working on the modalities for paying Zimbabwe's 260,000 civil servants in hard currency, backdated to January 2009. A paper, "Comprehensive Economic Reforms Needed to Turn Around the Economy," leaked from the RBZ (reftel) in mid January, suggested that the GOZ would begin paying civil servants 10 percent of their salaries in foreign exchange in January, rising to 100 percent in six months when the monthly salary and wage obligation to civil servants would be about US$240 million. The independent press has reported that the RBZ also planned to issue U.S. dollar-equivalent vouchers, redeemable for goods in shops. Kereke declined to confirm or

deny these reports.

And Some Market Reforms

¶4. (C) Kereke also said that the Grain Marketing Board (GMB) would be stripped of most of its activities, and the Zimbabwe National Water Authority (ZINWA) would return management of Harare's water delivery infrastructure to the Harare City Council. He also stated that the RBZ would cease - not simply ring-fence - all quasi-fiscal (i.e. off-budget) spending.

Financing it all - Taxes, Diamonds?

¶5. (C) Kereke told econoff that the RBZ had hardly any foreign reserves. The GOZ therefore planned to begin to finance its foreign exchange expenditures with hard-currency denominated revenue from corporate taxes, customs duty, VAT, and personal income tax. According to the leaked report, the government envisaged raising US$1.7 billion annually from taxes. Kereke said corporate taxes would fall from 30 percent to 15 percent to stimulate economic activity, and import duty rates would increase. Under dollarization, the government expected a sharp increase in formal employment, personal income tax collection, and VAT revenue. The exorbitant U.S. dollar prices in recently dollarized shops would begin to fall with increased competition. Asked how dollar-licensed businesses would react to the shift to no fee for new businesses to sell in hard currency, Kereke admitted that none of the licensed businesses had ever paid the prescribed US$20,000 fee.

¶6. (C) The leaked RBZ report estimated that diamond royalties could provide the GOZ with about US$1.2 billion per month in revenue (reftel). David Govere, President of the Employers' Confederation of Zimbabwe (EMCOZ), however, told econoff on January 25, that Kereke, who is his former business partner, had told him that the government in late December had given up hope of securing an up front infusion of US$5 billion from the Russians in return for rights to exploit the Chiadzwa diamond deposit.

"Near-Death" Economy

¶7. (C) Kereke said Governor Gono had convinced President Mugabe that the economy was in a "near-death" state due to the collapse in value of the local currency, and no alternative remained but to accept dollarization and pro-market reforms. Gono had reportedly pitched dollarization to Mugabe as key to taming hyperinflation. Kereke said Mugabe had also agreed to give up the official fixed exchange rate regime.

¶8. (C) Asked by econoff how the GOZ would finance its patronage system without the highly preferential exchange rate, Kereke suggested that new opportunities to make money legitimately in a liberalized market would compensate for the loss of state largesse to key supporters.

"Delusional" Revenue Estimates

¶9. (C) Our business contacts regard the government's leaked tax revenue estimates as wildly off the mark. Tinashe Rwodzi, Territory Senior Partner at PricewaterhouseCoopers in Harare, called the estimates "fantasy." He told econoff on January 26 that corporations were in dire straits, operating at only 5-15 percent capacity, and in desperate need of external support to jump start production. Phillip Chigumira, former Deputy President of the Confederation of Zimbabwe Industries (CZI), told us that almost 90 percent of Zimbabwe's production was now informal and most companies had not re-opened since the Christmas holidays. In these circumstances, Rwodzi said that companies would re-invest their forex earnings rather than declare taxable profit to the government. In his view, the amount of foreign exchange in circulation was woefully inadequate to even begin to finance private sector recovery. He also pointed out that by keeping the government printing press running and maintaining the Zimbabwe dollar alo
ngside hard currencies, companies might easily be tempted to manipulate the books and declare profit in (worthless) local currency terms and losses in their forex account. Chigumira pointed out that the RBZ failed to take into consideration the pace of emigration and of contraction of the formal sector, and the increase in informal economic activity that is not taxed. He said that CZI, in its submission to government, had advised the Ministry of Finance to devise ways of taxing informal traders.

¶10. (C) Rwodzi also said that the flow of remittances had declined significantly in Q4 2008 with the slowdown in the global economy. To make matters worse, remittances that previously had sustained a family for 4 weeks, could barely meet one week's cost of living at Zimbabwe's new inflated local U.S. dollar prices. Furthermore, he noted that remitted funds, for the most part, were primarily being spent on imported food and goods and did not remain in the economy.

¶11. (C) Tony Hawkins, University of Zimbabwe economics professor, called the tax revenue estimates, particularly from corporate taxes and personal income tax, "delusional" and "pie in the sky." He told econoff on January 26 that losses across the corporate sector were massive. The manufacturing sector, for example, was operating at only 5 percent capacity. The leaked RBZ report's diamond revenue assumptions were "bizarre," - more than four times Botswana's annual diamond exports. In regard to the possible introduction of foreign exchange coupons, he said no sane vendor would accept them. In his view, Gono's latest measures were an attempt to "stave off the inevitable." His advice to the opposition was to "sit on its hands" and watch

the decline accelerate.

¶12. (C) David Govere, for his part, told econoff that Gono had "a kitty" of revenue from diamond sales that could cover partial foreign exchange payment of January and February civil servant salaries, but no more.

The Squeeze on Government

¶13. (C) In the past, Gono was able to keep government operations going by printing Zimbabwe dollars, but that survival strategy has practically collapsed. Although he

recently announced the introduction of Z$10, Z$20, Z$50 and Z$100 trillion notes (after having lopped off 13 zeros from the currency in the past one and a half years), the evaporation of demand for Zimbabwe dollars means that he can no longer turn to the parallel market to meet the GOZ's hard currency expenditure requirements. On a recent weekend shopping tour, the only item emboff was able to buy for local currency, except at astronomical prices, was bananas from a street vendor. The collapse in value of the local currency has driven civil servants, including soldiers and policemen, to demand their salaries in foreign currency. Strikes by civil servants including teachers, health care workers and railroad employees over pay in hard currency have become common. At US$240 million/month, civil servant wages would exceed Zimbabwe's GDP, accor
ding to some estimates. GDP estimates range anywhere from US$1.5 billion to US$4 billion. Against this backdrop, the pressure to find other steady sources of foreign exchange is fierce.

Paranoia and Delusion Upstairs at the RBZ

¶14. (C) Prior to their meeting, Kereke asked econoff to present herself to the RBZ reception as a UNDP official, coming "to discuss the cholera situation." During the meeting, he pleaded that no reference be made to his name in any Embassy reports for fear of leaks back to the GOZ. To the suggestion of a meeting outside the RBZ, he said, if seen with an Embassy official, he would become "a corpse." On the imminent policy shift, Kereke maintained that the latest measures met all the policy recommendations outlined in the IMF's recent paper on overdue obligations. Asked if the RBZ had sought the IMF's advice on dollarization, Kereke said the "politics" were not right now for Zimbabwe's re-engagement with that institution. But he did dare to ask econoff, in closing, when Zimbabwe could expect to get USG backing for balance of payments support from the IMF.

COMMENT

¶15. (C) The GOZ appears to have a muddled understanding of dollarization. It wants to have it both ways: secure a hard currency anchor to tame inflation, collect tax revenue in forex, but persist in printing local currency with abandon. Its home-grown concept of "informal" adoption of hard currencies alongside the Zimbabwe dollar and not backed by any foreign reserves will neither stabilize the economy, attract desperately needed investment, nor meet the requirements for balance of payment support. In addition, foreign exchange is insufficiently available to anchor the Zimbabwe dollar in a currency board, and the GOZ has no hope of obtaining the needed funds. As Professor Hawkins suggested, Gono's latest "reforms" will not prevent the inevitable implosion of the formal economy. END COMMENT.

MCGEE